

Cultivating Opportunity



Amended and Restated

The Management's Discussion and Analysis as well as the Financial Statement portions of this report have been amended and restated.

The restated information supercedes the information contained in this printed report.

Sun Gro Horticulture Canada Ltd.

Founded in 1929 in Vancouver, British Columbia, Sun Gro is North America's largest producer of horticultural-grade peat and the largest distributor of peat moss and peat-based growing media to professional plant growers in the U.S. and Canada.



Sun Gro sells professional products primarily to greenhouse, nursery and specialty crop growers, as well as to golf course developers and landscapers. In addition, Sun Gro sells peat moss and peat-based growing mixes to retail customers, either by way of private label partnerships or under our own brand names.

The U.S. accounts for approximately 80% of total sales.

Our business strategy is founded on three key elements:

- 1 transitioning professional growers from peat to our higher-margin, pre-made growing mixes
- 2 expanding our position in the private label retail market
- 3 growing our business through strategic acquisition.



Sun Gro Horticulture Income Fund

Winspear Business Reference Library
University of Alberta
1-18 Business Building
Edmonton, Alberta T6G 2R6

Sun Gro Horticulture Income Fund (the Fund) is a limited purpose, open-ended trust created to acquire and hold the securities of Sun Gro Horticulture Canada Ltd. and the company's wholly owned subsidiaries (Sun Gro). Distributions to the Fund's unitholders, currently made monthly, are dependent on the performance of Sun Gro.

Performance highlights

For the period March 27, 2002 to December 31, 2002
(\$ thousands except per unit amounts)

Operations

Sales	\$	129.7
Operating income		9.4
Net income		11.7
Net income per unit		0.53

Distributable Cash and Distributions

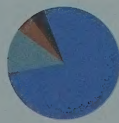
Distributable cash generated	\$	14.6
Distributions, paid or payable		19.2
Distributable cash generated per unit		0.66
Distributions declared per unit		0.87

- Launched the Sun Gro Horticulture Income Fund with the successful Initial Public Offering of 22,023,000 trust units, completed on March 27, 2002, and the subsequent acquisition of various assets and related businesses from Hines Horticulture, Inc., a leading U.S. commercial grower.
- Recorded net revenue of \$129.7 million and net income of \$11.0 million, generating basic and diluted earnings per unit of \$0.50 per unit.
- Paid forecast cash distributions, declaring nine monthly distributions to unitholders totaling \$0.87 per unit.
- Grew overall sales by 6%, and achieved record sales of value-added professional growing mixes during the nine months since the Fund's inception.



2002 Sales by Product

- Professional Mix - 52%
- Professional Peat - 26%
- Retail Mix - 6%
- Private Label Retail Mix - 3%
- Retail Peat - 6%
- Minerals & Fertilizer - 7%



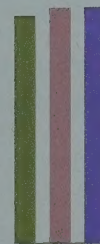
Geographic Sales Distribution

- USA - 78%
- Canada - 13%
- Mexico - 5%
- South America & Asia - 4%



2002 Profit Margin by Product

- Retail Products - 23.0%
- Professional Peat - 27.8%
- Professional Mix - 37.6%



Gross Margins

- 2000 - 48.9%
- 2001 - 50.7%
- 2002 - 50.8%

We are pleased to present the first annual report of Sun Gro Horticulture Income Fund and to welcome our new unitholders. This report covers our results for the nine-month period from the Fund's inception on March 27, 2002 to December 31, 2002.

The past year was both challenging and productive for Sun Gro Horticulture Canada Ltd. (Sun Gro). While our operating performance did not meet our expectations, due primarily to weaker than expected sales during the last two months of the year and the impact of some one-time charges, we maintained our forecasted distributions to unitholders. Throughout the year, we made steady progress toward achieving our long-term strategic objectives in both our professional and retail market segments. Today, Sun Gro is better positioned than ever to cultivate the many opportunities that exist to grow our business.

Operating Results and Distributions

For the nine-month period ended December 31, 2002, Sun Gro, the Fund's wholly owned subsidiary, recorded net sales of \$129.7 million and net earnings of \$11.7 million, or \$0.53 per unit.

During the nine months of our first fiscal year, the Fund announced nine cash distributions, declaring \$0.0900 per unit for the month of April and \$0.0979 for each subsequent month from May through December. As of December 31, 2002, the Fund had earned \$14.6 million (\$0.66 per unit) of distributable cash, declared \$19.2 million (\$0.87 per unit) to unitholders and distributed \$17.1 million.

Given the seasonality of Sun Gro's business and the Fund's policy of distributing cash on a level basis through the year, we expected distributions declared during the nine months of fiscal 2002 to exceed distributable cash earned by \$1.0 million. This is because the first quarter of 2002 was not included in the Fund's first year of operations and it, along with the second quarter, has historically been Sun Gro's most profitable period. However, when performance in the fourth quarter fell well below expectations, the difference between earned and declared distributions for the nine months increased to \$4.6 million. This shortfall, which resulted from a combination of lower than projected sales volumes and higher than expected costs, was covered by temporary borrowing against Sun Gro's revolving operating facility.

As we noted in the Fund's third quarter 2002 report, we expected fourth quarter sales to be below our initial projections as a result of the continuing economic uncertainty in our principal market – the United States. It was the size of the drop that was unexpected. In the final weeks of 2002, Sun Gro experienced a classic example of the domino effect. Economic uncertainty, and a resulting desire on the part of the large U.S. home and garden retailers to preserve working capital, caused retailers to delay placing their orders for nursery plants with



professional growers. The growers, in turn, delayed placing their orders for growing media with us, reducing our fourth quarter sales to levels significantly below our forecasts.

At the same time, fourth quarter costs were higher than anticipated. Because of the reduced sales levels, production rates at our U.S. mix plants dropped, increasing unit costs. In addition, general and administrative expenses were driven up by legal fees associated with a claim against a supplier. By year-end, the claim was settled in favor of the supplier and no additional costs are expected.

Despite these challenges, we continued to make steady progress in executing our business strategy.

Product Strategy

The key driver of Sun Gro's business is a growing passion for gardening, particularly among baby boomers. Heightened interest in making things grow can be attributed to a combination of social and demographic trends, including an aging population base, increased home ownership and the rapid expansion of "big box" retailers.

Increased demand for plants and gardening supplies means more business for professional growers – and greater demand for Sun Gro's high-quality growing media. Consequently, our primary focus is on the professional growers market – an established and

loyal customer base that tends to stick with a proven supplier who can help them achieve consistent results.

Our strategy is to transition these growers from straight peat moss, which they use to produce their own growing media, to Sun Gro's pre-made mixes, and from single orders to longer-term contracts. This helps growers stay competitive, by reducing labour costs, increasing consistency and improving greenhouse utilization, while enhancing sales of our value-added products. At the same time, we're working to expand our position in the private label retail market. This focus on private label products enables us to participate in the retail market without having to incur the marketing expense of supporting our own retail brands.

Operational Achievements

In 2002, we enhanced our leadership in the professional market, achieving record sales of our value-added mixes. For the nine months ended December 31, 2002, sales of these products were up by nearly 8% over the same period in 2001.



In particular, we strengthened our position in the important Southern California growing region through an expanded relationship with Color Spot, one of the largest commercial growers in the U.S. Results in 2003 will also be bolstered by the 20 new incremental long-term professional mix supply agreements we negotiated with growers in 2002.

On the retail side, we increased our private label business with a number of our larger customers. These include: BWI, a major distributor; the Albertson's food and drug chain; and Star Nursery, one of the largest independent regional nurseries in the U.S. We also signed a new agreement with the Proven Winners international marketing cooperative and are currently in the process of negotiating several major co-packing contracts.

At the production end, our new Seba Beach plant in Alberta, re-built with insurance proceeds following a fire in November 2000, is now fully re-integrated and delivering steadily improving performance. Across our 14-plant network, the introduction of a new quality standards program is both enhancing productivity and helping to control costs.

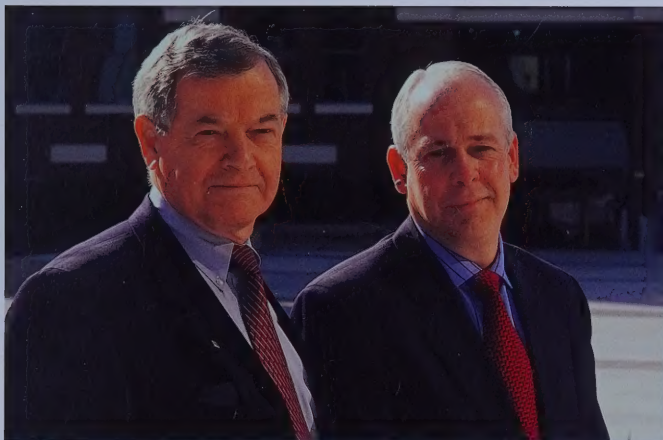
We also achieved our best ever safety record in 2002, with time lost due to workplace accidents significantly below the industry average. In addition, several major union contracts were favourably and amicably settled during the year. Sun Gro's labour relations are excellent and no labour disruptions are anticipated.

More detail on our strategies and achievements is provided in the pages that follow.

Outlook

As we begin a new year, economic conditions remain uncertain and we are facing increasing cost pressures, particularly on the energy front. In response, we are increasing our sales efforts, most notably with regard to our higher-margin professional mixes, and accelerating our cost control and productivity initiatives. These measures include a new fuel surcharge on deliveries, a program to reduce peat hauling costs, a reduction of early payment discounts to customers, cuts to transportation expenses and an across-the-board capital spending and compensation freeze.

We are pleased to report that early results suggest that a portion of the 2002 fourth quarter sales shortfall has shifted into the first months of 2003. Sales of our professional growing mixes have been particularly strong.



W. John Dawson

Mitchell J. Weaver

The fundamentals of our business remain sound and we expect ongoing improvement in our performance as a result of our new partnerships with customers like Proven Winners and Color Spot, and the strong actions we are taking on the cost side. We will continue to cultivate every opportunity for growth, both internally and externally. As we move forward, we will actively seek to enhance returns to unit-holders through strategic and accretive acquisitions.

We thank our unitholders for your confidence in Sun Gro; our professional and retail customers alike for your continued support; and our employees for your unfailing dedication to strengthening Sun Gro's business.

Mitchell J. Weaver
Trustee;
President and CEO

W. John Dawson, FCA
Chairman of the
Board of Trustees

With a long-term supply of high-quality peat, strong customer loyalty, established brand names and leading market share, Sun Gro is positioned to achieve solid future growth.

Management of Bog Resources



TWO-HEAD HARVESTER

To ensure a steady supply of high-quality sphagnum peat moss, the primary ingredient in our growing media products, Sun Gro has secured long-term harvesting rights to extensive peat bog reserves strategically located right across Canada. The geographic diversity of our supply reduces freight costs and lessens the impact of harvest curtailablements due to wet weather in any particular location.

During 2002, we enhanced our bog resources in several ways:

- We improved the life of our peat reserves by renewing 9,018 acres of existing leases.
- To maximize the quality and security of our harvest, we invested nearly \$400,000 in bog development in the nine months of 2002 following the Fund's inception.
- An additional \$800,000 was spent on bog development during the first quarter of 2002, when Sun Gro's assets were owned by Hines Horticulture.

At year-end, Sun Gro had approximately 52,000 acres of peat bogs under lease, under option to lease or with leases pending.



- Production/Distribution Facilities
- Distribution Facilities
- ▲ Customer Resource Centers



CANADIAN SPHAGNUM MOSS

PARTIALLY RESTORED BOG, SEBA BEACH, ALBERTA





PROCESSING PLANT
AND PEAT BOG,
ELMA, MANITOBA

Production Facilities

Sun Gro operates a network of 14 production facilities, comprising six Canadian peat and peat-mixing plants and eight U.S.-based mix plants. These plants support an extensive Canadian peat-harvesting operation, as well as bark-composting operations in the U.S. They also anchor an efficient product distribution network in support of our customers throughout North America and overseas.

During 2002, a number of milestones were achieved:

- Sun Gro's new, state-of-the-art processing facility in Seba Beach, Alberta became fully operational after being re-built following a fire in November 2000. Located 90 kilometres from Edmonton, adjacent to our extensive peat reserves, Seba Beach is Sun Gro's largest production facility. As 2002 progressed, the plant improved its operating performance each month.
- Our facility in Terrell, Texas achieved record sales and gross profit in 2002. This plant is one of the key production sites for private label retail mix manufactured for Bayer Corporation and marketed under the "Bayer Advanced Garden" brand.
- Sun Gro bettered an already exemplary plant safety record in 2002. The majority of our plants had no lost time accidents (LTAs) and only five minor LTAs were recorded during the year, less than a third of

the industry average. To ensure we maintain our outstanding safety performance, a comprehensive safety audit is planned for 2003.

- We continued to benefit from positive labour relations throughout the year. Labour contracts at three of our four unionized sites were up for renegotiation and all three were settled quickly and amicably for four-year terms.
- A comprehensive quality management program was implemented across our organization. Each of Sun Gro's 14 sites underwent quality management audits before and after implementation of the program. The vast majority achieved full compliance with the newly established quality standards during the year. As a direct result, we achieved a 21% reduction in customer claims.

ALL PROFESSIONAL MIXES
ARE AVAILABLE IN "BIG
SHOT" 55.0 CUBIC FOOT
COMPRESSED BALES





Professional Products

Professional products represent the core of Sun Gro's product portfolio. We offer a wide selection of professional peat moss and growing mixes. These are packaged in compressed or loose filled form and sold under the Sunshine® brand. We also produce custom mixes and sell water-soluble fertilizers and minerals to professional growers. Already the leading producer and distributor of peat products to professional growers, we are actively growing our market share by educating growers about the cost and quality benefits of Sun Gro professional mixes, and by providing outstanding technical support.

During 2002:

- We succeeded in negotiating 20 new long-term professional supply agreements with large and mid-sized growers. Many of the new contracts were supported by equipment bundling. In these cases, Sun Gro provides conveyers, mixers and bale handling equipment with our product offerings. This helps us cement our relationships with customers while enabling them to improve their productivity and profitability without the capital expenditure associated with equipment acquisitions.
- We signed a new agreement with Color Spot, one of the largest commercial growers in the U.S., extending our relationship to cover the important Southern California marketplace.
- We expanded our professional product offering with the December introduction of the Sunshine Ellepot Propagation System, a unique alternative to traditional rooting media. Since its origination in Denmark in 1992, the highly versatile Ellepot rooting plug system has gained huge popularity with professional growers around the world.



Sun Gro achieved record sales of our value-added professional mixes as a result of a more targeted approach to market development and enhancement of our distributor relationships. Consistent with our long-term strategy of transitioning professional growers from peat moss to our pre-made growing mixes, we achieved an 8% increase in mix sales, accompanied by a 2% decline in peat sales.



BACKED BY SUPERIOR TECHNICAL SUPPORT AND RESEARCH, SUN GRO PRODUCTS HELP PROFESSIONALS CONSISTENTLY GROW THE HIGHEST QUALITY PLANTS



Retail and Private Label Products

While we produce and sell several of our own brands, including our well-established Sunshine® products, to retailers in Canada and the U.S., Sun Gro's primary retail focus is the private label market. We package private label products for marketers, who sell the products under their own brands, and for retailers, who resell the products under their own in-store brands. This strategy allows us to market our retail grades of peat moss and to utilize available processing capacity while, at the same time, minimizing the costs associated with building and supporting our own retail brands.

During 2002, we recorded a number of successes:

- A new agreement to co-pack the Top Notch line of retail growing mixes for distribution across the central U.S has increased our retail business with BWI (Bunch Wholesale Inc.), one of our largest customers.
- Under a new private label agreement with Albertson's, Sun Gro is packaging "Savon by Osco" house brand potting soil for this leading U.S. food and drug retailer. Beginning in 2004, we will be the exclusive vendor for the product line across Albertson's 2,500-store nationwide chain.
- We rounded out our private label offerings with a number of major customers, adding new products for retailers such as Star Nursery, one of the largest independent retail chains in the country, and East Coast Garden Centers, a large buying cooperative on the Eastern seaboard.



- Under a new agreement with international marketing cooperative Proven Winners, Sun Gro is now producing a line of Proven Winners-branded soil mix, water-soluble fertilizer and time-release fertilizer under our Sunshine® label. Marketed in tandem with Proven Winners' flowering plants, these products will be available exclusively to independent garden centres.
- A new marketing program to revitalize our Sunshine® line has been well received by independent garden centres in the U.S. The line was reintroduced in 2002 as "Exclusive for the Independent Market" with the return of small packaging, an expanded product offering and availability of a mixed pallet of small sizes to help retailers manage their inventory.

Overview

Sun Gro Horticulture Income Fund (the "Fund") is a limited purpose, open-ended trust established under the laws of the Province of British Columbia. The Fund was created to acquire and hold, directly and indirectly, the securities of Sun Gro Horticulture Canada Ltd. and its wholly owned subsidiaries (collectively, "Sun Gro" or the "Company"). These subsidiaries are: Sun Gro Horticulture CM Ltd., Sun Gro Holdings Inc. and its subsidiaries, Sun Gro Horticulture Processing Inc. and Sun Gro Horticulture Distribution Inc.

The Fund commenced operations on March 27, 2002, when we completed an initial public offering ("IPO") of 22,023,000 units and acquired various assets and related businesses from Hines Horticulture, Inc. ("Hines") through the purchase of all of the outstanding securities of Sun Gro.

The Fund's activities are restricted to holding the securities of Sun Gro, receiving interest and dividend income, and distributing such income to unitholders. The financial condition and the results of the Fund are entirely dependent on the operations of Sun Gro. Distributions to the Fund's unitholders, currently made monthly, are likewise dependent on Sun Gro's performance.

The Fund's March 18, 2002 prospectus provided a financial forecast for Sun Gro's 2002 calendar year ("Forecast"). As the Fund did not commence operations until March 27, 2002, the business of Sun Gro was part of the operations of Hines for nearly three of the 12 months included in the Forecast. Accordingly, references in this Management's Discussion and Analysis to the "Forecast" and to "management's expectations" mean expectations of management for the nine-month period ended December 31, 2002, as extracted from the Forecast. Actual consolidated financial results for this period vary from the anticipated nine-month results underlying the Forecast.

Sun Gro's sales are subject to the seasonality of our customers' growing and selling cycles. Our business is also impacted by the seasonal nature of harvest and production. These seasonal factors create a discrepancy between distributable cash earnings and distributions. While the Fund has declared level distributions to provide a regular income stream to unitholders throughout the year, the first two quarters have historically been Sun Gro's most profitable, offsetting lower earnings during the second half of the year. Typically, about 55% of sales and 60% of operating income are generated in the first half of the year.

Results of Operations

Operating Results for the Period from March 27, 2002 to December 31, 2002

The Fund acquired Sun Gro on March 27, 2002. Therefore, the consolidated financial statements as at, and for the period ended, December 31, 2002 reflect the results of operations from March 27, 2002 to December 31, 2002. This partial year is the first year-end reporting period for the Fund. Accordingly, no comparative audited figures are presented. However, the underlying operations of Sun Gro are similar to those of the business as it was conducted by Hines in 2001. For evaluation purposes, management's discussion includes comparison to unaudited consolidated statements of earnings of the previous business for the nine months ended December 31, 2001 and to the consolidated statement of forecast income of Sun Gro Horticulture Canada Ltd. for the nine months ended December 31, 2002.

Comparative Financial Information

Actual and Forecast Results for the Period from March 27, 2002 to December 31, 2002

Statement of Earnings

(in thousands of dollars except per unit amounts and number of shares outstanding)

(Unaudited)

	Period from March 27, 2002 to December 31, 2002 ⁽¹⁾		Forecast for the Nine months ended December 31, 2002 ⁽²⁾	
Net revenue	\$	129,667 100%	\$	131,368 100%
Cost of goods sold		63,811 49%		61,321 47%
Gross profit		65,856 51%		70,047 53%
Selling and distribution expenses		40,398 31%		38,509 29%
General and administrative expenses		16,086 13%		14,556 11%
Total operating expenses		56,484 44%		53,065 40%
Operating income		9,372 7%		16,982 13%
Other income, net		65 0%		— 0%
Interest expense		(419) 0%		(615) 0%
Earnings before taxes		9,018 7%		16,367 12%
Current income tax recovery/(provision)		998 1%		(398) 0%
Future income tax recovery/(provision)		1,652 1%		(2,907) -2%
Net earnings for the period	\$	11,668 9%	\$	13,062 10%
Basic and diluted earnings per unit	\$	0.53	\$	0.59
Weighted average number of units outstanding		22,023,000		22,023,000

Selected supplemental revenue information

Volume in thousands of EBs

Total professional sales	6,832	6,947
Total retail sales	1,316	1,358
Total company sales	8,148	8,305

Average revenue per EB

Total professional sales	\$ 16.07	\$ 16.08
Total retail sales	15.10	14.50
Total company sales	\$ 15.91	\$ 15.82

Note: An equivalent bale "EB" is Sun Gro's standard unit of measure referring to 10 cubic feet of peat.

Statement of distributable cash

Net earnings for the period	\$	11,668	\$	13,062
Depreciation and amortization		5,684		4,607
Future income taxes		(1,652)		2,907
Capital expenditures		(1,302)		(2,318)
Loss on sale of property, plant and equipment		222		—
Distributable cash	\$	14,620	\$	18,258
Distributable cash per unit	\$	0.66	\$	0.83

(1) Actual results for the Sun Gro Horticulture Income Fund.

(2) Extracted from the Forecast for Sun Gro Horticulture Ltd., as described in the Prospectus, which was prepared in U.S. dollars and converted to Canadian dollars at the conversion rate of \$1.53.

Net revenue:

Revenue for the nine-month period from March 27, 2002 to December 31, 2002 was \$129.7 million, which was \$1.7 million, or 1%, under the Forecast revenue of \$131.4 million. The Forecast assumed 8.2% growth in sales volume compared to the actual 6.1% volume increase for the period. The volume shortfall occurred in December as professional customers delayed their planting schedules in response to later than normal ordering by their customers, the large home and garden retailers. Fourth quarter volumes were 2,474 equivalent bales (EBs), each representing 10 cubic feet of peat, compared to 2,615 EBs in the Forecast. The lower than expected volumes were partially offset by a 4% positive variance in average retail unit selling price caused by a slightly greater than anticipated proportion of mix sales relative to peat moss sales.

Of total sales, \$109.7 million, or 85%, came from professional products, which include professional-grade peat, as well as peat and bark-based growing mixes. The remaining \$20.0 million, or 15%, came from retail products. This ratio is consistent with the Forecast for the nine months and slightly different from what would be expected over a full 12-month period. That ratio would be approximately 80% professional and 20% retail.

For the period ended December 31, 2002, professional and retail growing mixes accounted for approximately 62% of sales, peat moss accounted for about 32%, and fertilizers and minerals made up the remaining 6%.

Cost of goods sold:

Cost of goods sold for the nine-month period was \$63.8 million, or 49% of revenue, compared to the Forecast cost of goods sold of \$61.3 million, or 47% of revenue. Cost of goods sold was higher than the Forecast, primarily due to higher fixed costs.

Bog depletion was one of several contributing elements. In the allocation of the purchase price, \$21.5 million of the excess over carrying values was allocated to bogs. As a result, the actual results included additional amortization of \$0.6 million for depletion. Harvest costs were also affected by lower than expected harvest volumes, which resulted from unusually wet weather conditions in eastern Canada. Other unfavourable variances in fixed costs included property insurance and repairs and maintenance.

As a result of lower revenues and higher cost of goods sold, gross profit was \$4.2 million less than forecast.

Selling and distribution expenses:

Selling and distribution expenses for the period were \$40.4 million, or 31% of revenue, and were \$1.9 million higher than the Forecast of \$38.5 million, or 29% of revenue. The increase was primarily due to amortization expense of \$1.0 million on the purchase price valuation of intangible assets. The allocation of the purchase price included \$30.4 million for brand names and customer relationships. Additional unfavourable variances were due to the continued effects of a fire that destroyed Sun Gro's Seba Beach, Alberta plant in November 2000. Increased distribution costs arose from an order backlog that resulted from the fire. These were carried over from the first quarter of 2002. The Seba Beach plant was rebuilt from insurance proceeds and became fully operational in the latter part of 2002.

General and administrative expenses:

General and administrative expenses for the period were \$16.1 million, or 13% of revenue, and were \$1.2 million higher than the Forecast of \$14.9 million, or 11% of revenue. The increase was due primarily to the \$1.1 million of legal fees that were incurred by Sun Gro in pursuing a product liability claim against a supplier. This claim was settled in favour of the supplier. No additional costs are expected in connection with the claim. In addition, actual results included \$0.3 million of amortization expense on the purchase price valuation of intangible assets for internally developed software. The remainder of the variance was due to the classification of withholding tax, more correctly, as a general and administrative expense. In the Forecast, withholding tax was included in the provision for income taxes.

Operating income:

Operating income for the period was \$9.4 million, or 7% of revenue, which was \$7.6 million less than the Forecast of \$17.0 million, or 13% of revenue. The variance is due to the factors described above. Of the difference, non-cash charges of \$1.9 million relate to amortization expense on the purchase price valuation of bogs and intangible assets.

Other income, net:

Other income, net of \$65,000 for the nine months, is comprised primarily of interest income on the amount due from Hines, offset by the bank's arrangement fee for setting up the revolving operating facility. The Forecast did not include any other income.

Interest expense:

Nine-month interest expense of \$0.4 million was in line with our expectations. Interest expense relates to a revolving operating facility, which Sun Gro used to support seasonal working capital needs. Average borrowings during the period were \$11.6 million at an average interest rate of 4.5%. In the Forecast, interest expense of \$16.9 million includes interest on \$173.2 million of notes to the Fund and interest on the revolving operating facility.

Provision for income taxes:

Sun Gro recorded an income tax recovery of \$2.7 million, compared to the Forecast income tax expense amount of \$0.4 million. This difference is primarily due to the decrease in actual net income, as compared to the Forecast, which generated a future income tax recovery of \$1.7 million and a current income tax recovery of \$1.0 million. The current recovery consists of a \$1.2 million carryback of tax loss to prior years offset by \$0.2 million of current capital taxes. The Forecast also included \$0.4 million of current income tax, which represented withholding tax on U.S. interest payments to Canada. Withholding taxes of \$0.3 million were classified as general and administrative expenses in the current period, which is a more appropriate characterization.

Net earnings:

Actual net earnings of \$11.7 million, or 9% of revenue, was \$12.4 million more than the Forecast net loss of \$0.7 million.

Results for the Period from March 27, 2002 to December 31, 2002 and the Nine Months Ended December 31, 2001

Statement of Earnings

(in thousands of dollars except per unit amounts and number of shares outstanding)

	Period from March 27, 2002 to December 31, 2002		(Unaudited) For the nine months ended December 31, 2001 ⁽¹⁾	
Net revenue	\$	129,667	100%	\$ 121,927 100%
Cost of goods sold		63,811	49%	65,420 54%
Gross profit		65,856	51%	56,507 46%
Selling and distribution expenses		40,398	31%	36,733 30%
General and administrative expenses		16,086	13%	15,183 13%
Total operating expenses		56,484	44%	51,916 43%
Operating income		9,372	7%	4,591 3%
Other income, net		65	0%	11,721 10%
Interest expense		(419)	0%	(7,722) (6%)
Earnings before taxes		9,018	7%	8,590 7%
Current income tax recovery/(provision)		998	1%	(2,514) (2%)
Future income tax recovery/(provision)		1,652	1%	(12,700) (10%)
Net earnings for the period	\$	11,668	9%	\$ (6,624) (5%)
Basic and diluted earnings per unit	\$	0.53		
Weighted average number of units outstanding		22,023,000		

Selected supplemental revenue information

Volume in thousands of EBs

Total professional sales	6,832	6,426
Total retail sales	1,316	1,251
Total company sales	8,148	7,677

Average revenue per EB

Total professional sales	\$ 16.07	\$ 16.05
Total retail sales	15.10	15.00
Total company sales	\$ 15.91	\$ 15.88

Note: An equivalent bale "EB" is Sun Gro's standard unit of measure referring to 10 cubic feet of peat.

(1) For this period, Sun Gro was part of Hines Horticulture, Inc. and financial results were reported in U.S. dollars. Those results have been converted into Canadian dollars at the average monthly rate for the nine-month period.

Net Revenue:

Revenue for the nine-month period from March 27, 2002 to December 31, 2002 of \$129.7 million was up \$7.8 million, or 6%, from revenue of \$121.9 million for the nine-month period ended December 31, 2001. The increased revenue is primarily due to the 6% increase in sales volume that was achieved in 2002.

Of total sales, \$109.7 million, or 85%, came from professional products, which include professional-grade peat, as well as peat and bark-based growing mixes. The remaining \$20.0 million, or 15%, came from retail products. During the same period in 2001, \$103.1 million, or 85% of total sales, came from professional products, while \$18.7 million, or 15%, came from retail products.

Cost of goods sold:

Cost of goods sold for the nine-month period in 2002 was \$63.8 million, or 49% of revenue, down \$1.6 million, or 2%, from \$65.4 million, or 54% of revenue, in the same period of 2001. Cost of goods sold decreased primarily due to the higher costs experienced in 2001 due to the Seba Beach fire. As a result of the Seba Beach plant closure, \$5.7 million in additional costs, or 5% of revenue, were incurred at other Sun Gro sites to meet production demand. Excluding the additional Seba Beach fire-related expenses, cost of goods sold as a percentage of revenue for the 2002 period was in line with the same period in 2001.

Selling and distribution expenses:

Selling and distribution expenses for the 2002 period were \$40.4 million, or 31% of revenue. This was \$3.7 million higher than the \$36.7 million in selling and distribution expenses, or 30% of revenue, that were incurred in the same period of the prior year. In 2001, the Seba Beach plant closure caused increased distribution costs of \$1.5 million. Comparing the 2002 expense to 2001, after excluding the incremental distribution costs, the 2002 costs were higher due to purchase price valuation of intangible assets, with associated amortization assigned to selling costs, and increased marketing expenses for our retail brands.

General and administrative expenses:

General and administrative expenses for the period were \$16.1 million, or 13% of revenue, which was \$0.9 million higher than the prior year's expenses of \$15.2 million, or 13% of revenue. The increase was due primarily to the legal fees of \$1.1 million that were incurred as a result of the product liability claim that Sun Gro pursued against a supplier. This claim was settled in favour of the supplier. No additional costs are expected in connection with the claim.

Operating income:

Operating income for the nine-month period in 2002 was \$9.4 million, or 7% of revenue, an increase of \$4.8 million from the same period in the prior year. In 2001, operating income was \$4.6 million, or 3% of revenue. The variance is due to the factors described above.

Other income:

Other income for the 2002 period was \$65,000 compared to \$11.7 million in 2001. In the prior year, \$12.7 million of insurance proceeds were received related to the Seba Beach plant fire. These proceeds were used to offset the additional production and distribution costs that were incurred during the period and to rebuild the plant.

Interest expense:

Interest expense was \$419,000 for the 2002 period. During the prior year period, \$7.7 million of interest expense was incurred on \$63.9 million of long-term debt and \$83.0 million of intercompany borrowings. Due to the change in capital structure with the inception of the Fund, long-term debt, intercompany borrowings and associated interest expense were eliminated. Sun Gro uses a revolving operating facility to support seasonal working capital needs. Average borrowings during the period were \$11.6 million at an average interest rate of 4.5%.

Provision for income taxes:

The income tax recovery of \$2.7 million for the 2002 period was due to the decreased net income and tax loss carryback described more fully earlier in this discussion. During the prior year period, \$15.2 million of taxes were

due. This \$17.9 million difference is due to the taxation changes affected by Sun Gro's conversion to an income fund. The primary component is a deferred income tax expense of \$12.7 million related to the difference between the book and tax basis for the investment in Sun Gro by Hines for the anticipated repatriation of foreign earnings in connection with the sale of Sun Gro Canada. Under the current trust structure, nearly all of the income of Sun Gro is distributed to unitholders and is taxable to them.

Net earnings:

Net earnings of \$11.7 million, or 9% of revenue, for the 2002 period were \$18.3 million more than the net loss of \$6.6 million for the same period in 2001. This was due to the factors discussed above.

Comparison of Actual Opening Balance Sheet to September 30, 2001 Pro Forma Balance Sheet

The Fund's March 18, 2002 prospectus provided pro forma financial statements dated September 30, 2001. The purchase equation included in those statements differed from the actual transaction, which occurred on March 27, 2002. There were two main reasons for the difference.

First, the transaction closed near the peak of Sun Gro's working capital demand, when sales activity is well in excess of cash collections. As a consequence, accounts receivable, which were \$34,642,000 (US\$21,939,000) in the pro forma, were actually \$50,022,000 at the closing of the transaction on March 27, 2002. Advances were made under the revolving operating facility to meet the working capital demand and formed part of the cash consideration paid to Hines.

The second reason is that the cash and short-term deposits shown on the pro forma balance sheet were used to acquire goodwill and intangible assets from Hines. The transaction as contemplated in the prospectus was a payment of \$203,713,000 to Hines for the purchase of the Sun Gro business. The fair value of the identifiable tangible assets at September 30, 2001 was \$170,271,000 (US\$107,835,000) and the assumed liabilities were \$34,980,000 (US\$22,153,000). The net of the two items approximates the goodwill and intangible assets created by the purchase.

Other smaller factors also contributed to the difference between the actual and pro forma balance sheets, including differences in exchange rates and other changes in working capital.

Comparison of results for the period December 30, 2001 to March 26, 2002 to the Forecast for the three months ended March 31, 2002

The following is presented for informational purposes only. The Forecast was for calendar 2002. The Fund acquired the business of Sun Gro on March 27, 2002 and therefore, actual financial results for the period December 30, 2001 to March 26, 2002 are not part of the Fund's results of operations. As the business of Sun Gro was owned by Hines Horticulture Inc. until March 26, 2002, the unaudited results for the period refer to the previous structure of Sun Gro. The actual period was three business days shorter than the Forecast period. We estimate that the three business days reflect approximately 3% of the variances incurred in operating income line items.

Actual sales of \$49.5 million were 9% lower than the Forecast of \$54.4 million for the period. This was due to the shorter reporting period and lower than forecast sales of retail mix, retail peat and professional mix. Actual cost of goods sold as a percentage of sales was 54%, compared to 50% in the Forecast. Of this variance, \$1.7 million or 3% is attributable to additional production costs associated with the fire at Sun Gro's Seba Beach facility. The remaining 1% is primarily a result of higher per unit fixed costs due to the lower sales volumes.

Selling and distribution expenses for the period were \$13.8 million, or 28% of revenue. This was approximately 2% of revenue higher than the Forecast of \$14.1 million. The primary factor was higher distribution expenses in

the aftermath of the Seba Beach fire as products had to be shipped from other production facilities to meet our delivery commitments. We also incurred additional selling costs due to an increased marketing effort designed to bolster future retail sales. General and Administrative expenses of \$6.4 million were \$1.3 million greater than the Forecast due to costs associated with the Seba Beach fire, as well as certain non-recurring accruals made in connection with the Sun Gro reorganization.

Operating income for the period was \$2.5 million or 5% of revenue, compared to Forecast operating income of \$8.1 million or 15% of revenue. The difference was due to the factors described above. Interest expense for the period totaled \$2.0 million related to debt due to Hines. The Forecast assumed no interest expense in the first quarter as all debt with Hines was expected to be eliminated in the new company structure. Taxes for the period were \$0.2 million based on actual earnings, compared to Forecast deferred taxes of \$2.9 million.

Liquidity and Capital Resources

The Fund's IPO, completed March 27, 2002, raised net proceeds of \$203,713,000, after deducting expenses of \$16,517,000, through the sale of 22,023,000 units. The net proceeds were used to acquire various assets and related businesses from Hines through the purchase of all of Sun Gro's outstanding common shares.

Cash flow generated by Sun Gro is required to fund distributions to unitholders, interest, repayment of debt and capital expenditures. For the period ended December 31, 2002, cash flow from operating activities after changes in non-cash working capital was \$10.1 million. The non-cash components of working capital increased by \$5.9 million from the March 27, 2002 opening balance sheet date. This increase was primarily driven by increases in inventory and decreases in payables, offset by a decrease in trade accounts receivable. During the nine-month period, trade accounts receivable declined by \$13.5 million. The decrease in trade accounts receivable is greater than a typical full year's activity would reflect as the opening balance sheet date already included the seasonally higher first quarter sales.

Cash used for investing activities consisted of capital expenditures of approximately \$1.3 million. Forecast expenditures were \$2.3 million. Capital spending in 2002 focused on bog development, which accounted for \$400,000, or 30% of total capital spending for the nine months. Approximately \$800,000 was spent for bog development in the first quarter of 2002, prior to the inception of the Fund.

Cash used for financing activities consisted of \$5.8 million to pay down the operating line and \$17.1 million of cash distributions to unitholders.

In lieu of holding significant cash balances, Sun Gro utilizes the revolving operating facility to fund seasonal working capital demand. The balance owed under the facility increases beginning in late summer and peaks early in the second quarter. This pattern is driven by the fact that Sun Gro's professional customers use our products at the initial stage of their production cycle, and in turn don't receive payment from their customers until the crop is delivered. Depending on the crop, this cycle can last up to nine months.

When the Fund purchased Sun Gro on March 27, 2002, the initial drawdown on the revolving operating facility was \$19.8 million. This drawdown represented part of the purchase price paid to Hines at the closing of the IPO and was based on an assumed level of working capital. Subsequently, when working capital was measured, \$13.4 million was refunded to Sun Gro by Hines. The largest level of borrowings in the nine-month 2002 period was \$24.0 million in April. We expect that borrowings in 2003 will peak at approximately \$25 to \$27 million.

Sun Gro currently has a revolving operating facility of up to \$30.0 million, including US \$5.0 million, which can be drawn on by our U.S. subsidiaries, to fund our working capital and general corporate requirements. The amount of operating line available is dependent upon meeting certain covenant requirements. As at December 31, 2002, the full \$30.0 million of the facility was available. Of this, Sun Gro had drawn \$14.0 million bearing interest at the Canadian prime rate. The inventories and trade accounts receivable are provided as security.

Sun Gro generally expects to meet future financing needs through cash flow from operations and, if required, from additional bank borrowings.

Given the seasonality of Sun Gro's business and the Fund's policy of distributing cash on a level basis through the year, management expected to declare distributions of \$1.0 million more than the distributable cash earned during the nine-month period of fiscal 2002. However, performance in the fourth quarter of 2002 fell below expectations and as a result, the distributable cash earned for the nine-month period fell short of declared distributions by \$4.6 million, or \$0.21 per unit. This shortfall was substantially developed in December, as that month's sales fell well below forecast. The shortfall has been temporarily covered by utilizing Sun Gro's revolving line of credit.

Outlook

Management has adopted a budget for 2003 that supports the current level of distributions. Achievement of the budget will depend on reaching revenue and cost goals. In response to increasing cost pressures, a number of cost control measures have been implemented. These include a new fuel surcharge on deliveries, a program to reduce peat hauling costs, a reduction of early payment discounts to customers, cuts to transportation expenses and an across-the-board freeze on capital spending and compensation. However, factors may develop during the year that have a material impact on Sun Gro's ability to achieve the 2003 budget.

We continue to remain focused on serving the professional growers market, and strengthening our private label retail program. With new partnerships and expanded relationships with major customers like Proven Winners and Color Spot, we are on track to improve our sales performance for 2003.

Risks and Uncertainties:

The Fund is a limited purpose trust which is entirely dependent upon the operations and assets of Sun Gro through the Fund's ownership of Sun Gro common shares and Sun Gro Notes. Accordingly, the Fund's ability to make cash distributions to the unitholders is dependent upon the ability of Sun Gro to satisfy our interest obligation under the Sun Gro Notes and to declare any dividends or other return of capital in respect of the Sun Gro Common Shares. This ability is, in turn, dependent upon the operations and assets of Sun Gro and our subsidiaries.

Resource Supply. Sun Gro leases approximately 47,000 acres of land in Canada from provincial governments from which we harvest our peat. Although we have historically been able to renew our leases upon expiration on terms not materially different than under existing leases, there can be no assurance that Sun Gro will be able to do so in the future. The inability to renew these leases, or to renew them on substantially the same terms, could have a material adverse effect on Sun Gro. During 2002, we renewed leases on approximately 9,000 acres of peat harvest land in Canada. These renewals were completed on terms substantially the same as the expiring terms.

Competition. Sun Gro competes with several large Canadian peat producers and with other competitors. The price and profitability of peat depends to a large extent on supply and demand, which in turn can be affected by harvest conditions. Management believes that Sun Gro can compete effectively due to our ability to provide consistent, high-quality products in large volumes, our well-established distribution network and our value-added services.

Effect of Seasonality, Weather and Other Factors. Sun Gro's production of peat moss and peat-based growing mixes may be negatively affected by unusual weather conditions. For example, the harvest of peat, which requires dry weather, may be hampered by unseasonable rain. In addition, Sun Gro stores peat in large piles outside that can be damaged by severe weather conditions. To mitigate extreme weather risks, Sun Gro's harvest operations are geographically diversified with locations across Canada.

Adverse weekend weather during the spring selling season can materially affect the demand for green goods and consequently, the financial performance of Sun Gro's customers. It can also affect the sales of Sun Gro's retail products, including company brands and private label products. This risk is mitigated to a certain degree by the sales of products to customers throughout North America.

Operational Risk. Sun Gro is subject to potential product liabilities connected with our operations, including liabilities and expenses associated with product defects. We have in place product liability and other insurance coverage that management believes will generally be in accordance with the diversity of crops and customers. There can be no assurance that Sun Gro will always be adequately insured against all such potential liabilities.

Sun Gro's peat harvesting and other operations are subject to federal and provincial regulation and peat harvesting in general has received attention from various environmental agencies. These agencies may affect Sun Gro by regulating or prohibiting certain procedures or aspects of our operations. Management does not anticipate that future expenditures for compliance with such environmental laws and regulation will have a material adverse effect on Sun Gro. No assurance can be given, however, that such compliance with other laws and regulation that may be enacted in the future, will not have a material adverse effect on Sun Gro.

Sun Gro has unionized operations at a number of our harvest and production locations. No labour stoppages have occurred since the establishment of the Fund; however future strikes, lockouts or stoppages could restrict Sun Gro's ability to service customers and consequently adversely affect revenue. Sun Gro renewed collective bargaining agreements with all of our unionized facilities during 2002, with expiry dates ranging from December 31, 2003 to May 28, 2006. Historically, labour relations with Sun Gro employees have been good and management believes they will remain positive into the future.

Reliance on Key Personnel. Sun Gro's success is largely dependent on the skills, experience and efforts of senior management. The loss of services of one or more members of senior management could have a material adverse effect on Sun Gro.

Sun Gro does not maintain key-man life insurance policies on any members of management. No members of senior management are bound by non-competition agreements, and if any such members were to depart and subsequently compete with Sun Gro, such competition could have a material adverse effect.

Foreign Exchange Risk. A significant portion of Sun Gro's consolidated costs are incurred in Canadian dollars, while the majority of Sun Gro's consolidated revenues are earned in U.S. dollars. As a result, Sun Gro's operations are subject to the risks normally attributable to fluctuations in foreign currency values. There can be no assurance that currency fluctuations will not have a material adverse effect on Sun Gro.

To reduce the risks of exchange rate fluctuations, Sun Gro has entered into forward exchange contracts for the purchase of Canadian dollars. As at December 31, 2002 Sun Gro had forward exchange contracts to sell US\$16.4 million, maturing monthly through December 2003. Additional hedges may be acquired, subject to review of market conditions.

Forward-looking Statements:

This Annual Report may contain forward-looking statements. Such statements involve known and unknown risks, uncertainties and other factors outside management's control that could cause actual results to differ materially from those expressed in the forward-looking statements. The Fund does not assume responsibility for the accurateness and completeness of the forward-looking statements and does not undertake any obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.

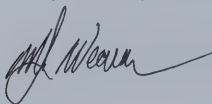
Management's Responsibility

The management of Sun Gro is responsible for the preparation, integrity and fair presentation of the accompanying consolidated financial statements and other information contained in this annual report. The consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in Canada and reflect where necessary management's best estimates and judgements. Financial information provided elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

Management is also responsible for maintaining systems of internal and administrative controls to provide reasonable assurance that the Fund's assets are safeguarded, that transactions are properly executed in accordance with appropriate authorization and that the accounting systems provide timely, accurate and reliable financial information.

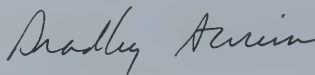
The Board of Directors of Sun Gro is responsible for assuring that management fulfills its responsibility for financial reporting and internal controls. The Board maintains an Audit Committee and performs this responsibility at meetings where significant accounting, reporting and internal control matters are discussed. The Audit Committee is entirely comprised of independent directors who meet periodically during the year with the external auditors and management to review the consolidated financial statements, the adequacy of financial reporting, accounting systems, and controls and external auditing functions. The auditors have full access to the Audit Committee and meet with the committee both with and without the presence of management.

The consolidated financial statements of the Fund have been audited by PricewaterhouseCoopers LLP, the external auditors whose report follows. The Auditors' Report outlines the scope of their examination and their independent professional opinion on the fairness of these financial statements.



Mitchell J. Weaver

*President and Chief Executive Officer,
Sun Gro Horticulture Canada Ltd.*



Bradley A. Wiens

*Vice-President, Finance and Chief Financial Officer,
Sun Gro Horticulture Canada Ltd.*

Auditors' Report

To the Unitholders of Sun Gro Horticulture Income Fund

We have audited the consolidated balance sheet of Sun Gro Horticulture Income Fund (the "Fund") as at December 31, 2002 and the consolidated statement of earnings and cumulative earnings and cash flows for the period from March 27, 2002 to December 31, 2002. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2002 and results of operations and cash flows for the period from March 27, 2002 to December 31, 2002 in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

Vancouver, Canada, March 6, 2003

Consolidated Balance Sheet

(in thousands of dollars)

As at December 31, 2002

Assets

Current assets

Accounts receivable	\$	36,520
Inventories (note 3)		26,550
Prepaid expenses and other assets		6,424
		<u>69,494</u>

Property, plant and equipment (note 4)		127,709
Goodwill		22,973
Other intangible assets (note 5)		32,320
	\$	<u>252,496</u>

Liabilities and Unitholders' Equity

Current liabilities

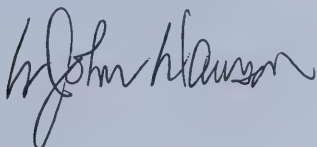
Bank indebtedness	\$	394
Operating line (note 6)		13,997
Accounts payable and accrued liabilities (note 7)		10,710
Distribution payable to unitholders (note 8)		2,156
		<u>27,257</u>

Future income taxes (note 10)		24,169
		<u>51,426</u>

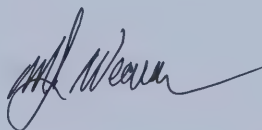
Unitholders' equity

Capital contributions (note 9)		209,733
Cumulative translation account		(1,101)
Net earnings for the period		11,668
Distributions declared (note 8)		(19,230)
		<u>201,070</u>
	\$	<u>252,496</u>

Approved by the Trustees



W. John Dawson, FCA
Chairman of the
Board of Trustees



Mitchell J. Weaver
Trustee; President and CEO

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Earnings

(in thousands of dollars except per unit amounts and
number of units outstanding)

	Period from March 27, 2002 to December 31, 2002
Net revenue	\$ 129,667
Cost of goods sold	63,811
Gross profit	65,856
Selling and distribution expenses	40,398
General and administrative expenses	16,086
Total operating expenses	56,484
Operating income	9,372
Other income, net	65
Interest expense	(419)
Earnings before income taxes	9,018
Income tax recovery (note 10)	2,650
Net earnings	\$ 11,668
Basic and diluted earnings per unit	\$ 0.53
Weighted average number of units outstanding	22,023,000

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

(in thousands of dollars)

	Period from March 27, 2002 to December 31, 2002
Cash flows from operating activities	
Net earnings for the period	\$ 11,668
Items not affecting cash	
Depreciation and depletion	4,394
Amortization of other intangible assets	1,290
Loss on sale of property, plant and equipment	222
Future income taxes	(1,652)
	15,922
Change in non-cash operating working capital	(5,861)
	10,061
Cash flows used in investing activities	
Acquisition (note 1)	(203,713)
Purchase of property, plant and equipment	(1,302)
Proceeds from sales of property, plant and equipment	184
	(204,831)
Cash flows from financing activities	
Issuance of units (note 9)	220,230
Cost of issuance (note 9)	(16,517)
Decrease in receivable from Hines Horticulture, Inc. (note 1)	13,371
Distributions paid to unitholders	(17,074)
Decrease in operating line	(5,786)
	194,224
Effect of exchange rate changes on cash	152
Increase in bank indebtedness and bank indebtedness at end of period	\$ (394)
Supplemental cash flow information	
Interest paid	\$ 367
Income taxes paid	\$ 198

Notes to the Consolidated Financial Statements

(in thousands of dollars except per unit amounts)

1. Organization and description of the business

Sun Gro Horticulture Income Fund (The "Fund") is a limited purpose, open-ended trust established under the laws of the Province of British Columbia on February 12, 2002. The Fund was created to acquire and hold the securities of Sun Gro Horticulture Canada Ltd., ("Sun Gro"). Sun Gro, founded in 1929 in Vancouver, British Columbia, is the largest producer of horticultural-grade peat in North America and the largest distributor of peat moss and peat-based growing media to North American professional plant growers. Sun Gro sells its professional products primarily to greenhouse, nursery and specialty crop growers throughout North America, as well as to golf course developers and landscapers. Sun Gro also sells peat moss and peat-based mixes to retail customers, either by way of private label partnerships or by selling products under its own brands directly to retail customers.

On March 27, 2002, the Fund issued 22,023,000 units at a price of \$10.00 per unit pursuant to an Initial Public Offering for net proceeds of \$209,733,000, after deducting expenses of the offering of \$16,517,000 (less future income tax assets of \$6,020,000). On March 27, 2002, the Fund acquired all of the outstanding securities of Sun Gro and its subsidiaries from Hines Horticulture, Inc. ("Hines") for cash consideration of \$203,713,000.

The acquisition has been accounted for by the purchase method and the results of Sun Gro have been included in the Fund's consolidated financial statements from the date of acquisition. These consolidated financial statements reflect the assets and liabilities of Sun Gro at assigned fair values as follows:

Accounts receivable	\$	50,022
Inventories		20,385
Working capital adjustment due from Hines		13,493
Prepaid expenses and other assets		4,480
Property, plant and equipment		131,218
Goodwill		22,973
Other intangible assets		
Brand names		14,756
Customer relationships		16,644
Internally developed software and databases		2,210
Operating line		(19,783)
Accounts payable and accrued liabilities		(20,844)
Future income tax liability		(31,841)
Consideration paid in cash	\$	203,713

2. Significant accounting policies

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada.

Fiscal year end

The fiscal year end of the Fund is December 31. The fiscal year end of Sun Gro and its subsidiaries is a 52-week or 53-week period ending on the Sunday nearest to December 31. Fiscal year 2002 ended on December 29, 2002. The financial statements of the Fund for the period from March 27, 2002 to December 31, 2002 include Sun Gro and its subsidiaries for the period from March 27, 2002 to December 29, 2002.

Basis of consolidation

The consolidated financial statements include the accounts of the Fund and its wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated on consolidation.

Cash and cash equivalents

Cash equivalents comprise highly liquid investments having original terms to maturity of 90 days or less when acquired. They are valued at cost plus accrued interest, which approximates market value.

Inventories

Inventories are stated at the lower of average cost or net realizable value. Cost of finished goods includes materials, labor and manufacturing overhead.

Property, plant and equipment

Property, plant and equipment are depreciated on a straight-line basis according to the following estimated useful lives:

Buildings	20 years
Machinery and equipment	3 to 8 years

Peat bog depletion is based on the volume of peat produced during the period at rates that will amortize the bog acquisition costs, as well as initial bog clearing, development and reclamation costs over the period of production of peat from the bog.

The Fund provides for the reclamation of peat bogs based on existing reclamation standards and the requirements of the Fund's various peat bog leases.

Depreciation of property, plant and equipment, including peat bog depletion, is included in cost of goods sold except for depreciation not directly related to production which is included in general and administrative expenses.

Goodwill

Goodwill is recorded at cost and is not amortized. Management tests goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Goodwill is written down when the carrying value exceeds the fair value.

Other intangible assets

Other intangible assets represent assets acquired that lack physical substance and that meet the specified criteria for recognition apart from goodwill. Other intangible assets include brand names, customer relationships and internally developed software and databases. The Sunshine brand name has been determined to have an indefinite useful life and is not amortized. The remaining other intangible assets are amortized on a straight-line basis according to the following estimated useful lives:

Brand names	10 years
Customer relationships	3 to 20 years
Internally developed software and databases	5 to 10 years

Management reviews the carrying value of the Sunshine brand name for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Sunshine brand name will be written down if the carrying amount of the asset exceeds its fair value. Other intangible assets with a finite life are written down when the carrying amount exceeds the net recoverable amount.

Revenue recognition

Revenues are earned from the sale of various grades of peat moss, peat-based and bark-based growing mixes, water-soluble fertilizers and minerals. The Fund classifies amounts charged to its customers for shipping and handling costs as part of its revenues. Revenues are recognized at the time of shipment to the customer, net of rebates and discounts. Costs incurred for shipping and handling of products to customers are recognized as part of selling and distribution expenses.

Reporting currency and foreign currency translations

The accounts of the Fund's foreign operations are considered to be self-sustaining and are translated into Canadian dollars using the current rate method. Assets and liabilities are translated at the rates in effect at the balance sheet date and revenue and expenses are translated at average exchange rates for the period. Gains or losses arising from the translation of the financial statements of self-sustaining foreign operations are deferred in a cumulative translation account until there is a realized reduction in the net investment.

Income taxes

Income taxes are accounted for using the asset and liability method. Under this method, future tax assets and liabilities are recognized for temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the assets are realized or the liabilities settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that enactment or substantive enactment occurs.

Distributions to unitholders

The Fund's distribution policy is to make distributions to unitholders of its available cash to the maximum extent possible. The Fund intends to make monthly cash distributions of its net monthly cash receipts from Sun Gro, less estimated amounts required for the payment of expenses and cash redemption of units.

It is anticipated that cash distributions will be payable monthly to the unitholders of record on the last business day of each month and will be paid no later than the 15th day of the following month or, if such day is not a business day, no later than the next business day. The cash receipts of the Fund depend on the performance of Sun Gro and its payment of dividends and interest on the securities of Sun Gro held by the Fund. Due to the seasonality of Sun Gro's operations and cash flows during certain months, the operating line of credit is used to supplement Sun Gro's available cash.

The Board of Directors of Sun Gro has adopted a policy to distribute to the Fund all of Sun Gro's available cash, subject to applicable law, by way of monthly dividends after (i) satisfaction of its debt service obligations, if any; (ii) satisfaction of its interest (including interest accrued or payable on the notes of Sun Gro held by the Fund and interest payable in respect of drawings under its credit facility), payment of taxes, and other expense obligations; (iii) provisions for sustaining capital expenditures in respect of Sun Gro's assets; (iv) making any principal repayments on the notes of Sun Gro held by the Fund considered advisable by the Board of Directors of Sun Gro with the consent of the Fund; and (v) retaining such reasonable working capital reserves as may be considered appropriate by the Board of Directors.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Hedging

The Fund generates a significant portion of its operating cash flows in U.S. dollars and makes distributions to unitholders in Canadian dollars. The Fund utilizes foreign currency hedge contracts to manage its exposure to fluctuations in the Canadian/U.S. dollar exchange rate. The Fund's policy is not to utilize foreign currency contracts for trading or speculative purposes.

The Fund documents relationships between hedging instruments and hedged items, as well as its risk management objectives for undertaking various hedging transactions. This process includes relating any derivative instruments to forecasted Canadian dollar cash flows. The Fund also assesses, on an ongoing basis, whether the derivative instruments used in its hedging program are effective in offsetting changes in the hedged items. Foreign exchange gains or losses on foreign currency contracts are recorded as the contracts mature.

3. Inventories

	December 31, 2002
Raw materials	\$ 7,930
Scratch peat	2,550
Packaging	4,186
Finished goods	11,884
	\$ 26,550

4. Property, plant and equipment

December 31, 2002			
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Peat bog acquisition and development costs	\$ 83,718	\$ (2,086)	\$ 81,632
Land	3,967	—	3,967
Buildings	19,672	(701)	18,971
Machinery and equipment	24,744	(1,605)	23,139
	\$132,101	\$ (4,392)	\$ 127,709

5. Other intangible assets

December 31, 2002			
	Cost	Accumulated Amortization	Net Book Value
Brand names			
Sunshine	\$ 13,753	\$ —	\$ 13,753
Other	1,003	(75)	928
Customer relationships	16,644	(914)	15,730
Internally developed software and databases	2,210	(301)	1,909
	\$ 33,610	\$ (1,290)	\$ 32,320

6. Operating line

Sun Gro has a committed revolving facility of up to \$30.0 million during the period November 1 through June 30 each year and \$15.0 million during the period July 1 through October 31 each year, due to the seasonal nature of working capital requirements. The revolver facility includes US\$5.0 million which can be drawn on by Sun Gro's U.S. subsidiaries, to fund Sun Gro's working capital and general corporate requirements. The revolver facility matures on March 31, 2004. The amount of operating line available is dependent upon meeting certain covenant requirements. As of December 31, 2002, Sun Gro was in compliance with covenant requirements and the full amount of the facility was available. Sun Gro had drawn \$14.0 million bearing interest at the Canadian prime rate of 4.5% at December 31, 2002. Inventories and trade accounts receivable are provided as registered security.

7. Accounts payable and accrued liabilities

December 31, 2002	
Trade accounts payable	\$ 4,803
Employee compensation payable	3,442
Other accrued liabilities	2,465
	\$ 10,710

8. Distributions to unitholders

During the period ended December 31, 2002, the Fund declared distributions to the unitholders of \$19,230,000 or \$0.87 per unit. The amounts and record dates of these distributions were as follows:

2002 Record Date	Amount	Per Unit
April 30	\$ 1,982	\$ 0.0900
May 31	2,156	0.0979
June 28	2,156	0.0979
July 31	2,156	0.0979
August 30	2,156	0.0979
September 30	2,156	0.0979
October 31	2,156	0.0979
November 29	2,156	0.0979
December 31	2,156	0.0979
	\$ 19,230	\$ 0.8732

The distribution of \$2,156,000 with a record date of December 31, 2002 was accrued at December 31, 2002 and paid in January 2003.

The distributions declared have been allocated as follows for income tax purposes:

	Period from March 27, 2002 to December 31, 2002
Taxable – interest	\$ 17,659
Taxable – dividends	1,571
Total distribution	\$ 19,230
Per unit	\$ 0.8732

Distributable cash was as follows:

	Period from March 27, 2002 to December 31, 2002
Net earnings for the period	\$ 11,668
Net earnings adjustments	
Depreciation, depletion and amortization	5,684
Future income taxes	(1,652)
Purchase of property, plant and equipment	(1,302)
Loss on sale of property, plant and equipment	222
Distributable cash	\$ 14,620
Distributable cash per unit	\$ 0.66

9. Units

The Declaration of Trust provides that an unlimited number of units may be issued. Each unit is transferable and represents an equal undivided beneficial interest in any distributions of the Fund and in the net assets of the Fund. All units have equal rights and privileges. Each unit entitles the holder thereof to participate equally in allocations and distributions and to one vote at all meetings of unitholders for each whole unit held. The units issued are not subject to future calls or assessments. Units are redeemable at any time at the option of the holder at amounts related to market prices at the time, subject to a maximum of \$50,000 in cash redemption by the Fund in any particular month. This limitation may be waived at the discretion of the Trustees of the Fund. Redemption in excess of this amount, assuming no waiving of the limitation, shall be paid by way of a distribution in specie of a pro rata number of Sun Gro securities held by the Fund.

On March 27, 2002, the Fund issued 22,023,000 units at \$10.00 per unit pursuant to an Initial Public Offering. Expenses of the offering amounted to \$16,517,000 (less related future income tax assets of \$6,020,000) and were charged to unitholders' equity.

	Units Outstanding		
Issuance of units	22,023,000	\$	220,230
Less: Expenses of the offering net of future income tax assets	—		(10,497)
	22,023,000	\$	209,733

10. Income taxes

The Fund is a Unit Trust for income tax purposes and, accordingly, the Fund is taxable only on any taxable income not allocated to the unitholders. Subsidiaries of the Fund are normal taxable entities. During the period ended December 31, 2002, all taxable income of the Fund has been distributed to unitholders. Any income tax obligations relating to the distributions are the obligations of the unitholders.

The consolidated tax recovery was as follows:

	Period from March 27, 2002 to December 31, 2002
Current income taxes	\$ 998
Future income taxes	1,652
	\$ 2,650

Income tax expense varies from the amount computed by applying combined Canadian federal and provincial tax rates to earnings before income taxes as follows:

	Period from March 27, 2002 to December 31, 2002
Earnings before income taxes	\$ 9,018
Income tax expenses at statutory rates	3,287
Income tax deductions on interest paid to the Fund	(6,519)
Large corporations tax	198
Non-deductible expenses	439
Other	(55)
	\$ 2,650

Temporary differences that gave rise to future income tax assets and liabilities are as follows:

	December 31, 2002
Future income tax assets (liabilities)	
Property, plant and equipment	\$ (32,328)
Other intangible assets	1,819
Share issue costs	5,688
Tax loss carryforwards	528
Other	124
	\$ (24,169)

The Fund's subsidiaries have non-capital tax loss carryforwards of \$903,000 which expire in 2009 and \$540,000 which expire in 2022.

11. Commitments and contingencies

Lease commitments

The Fund has various operating lease commitments relating primarily to bog sites, office and warehouse facilities requiring the following future minimum annual lease payments as of December 31, 2002:

2003	\$	3,090
2004		2,384
2005		1,236
2006		425
2007		333
Thereafter		122
	\$	7,590

Total rent expense under these operating lease agreements for the period ended December 31, 2002 was \$2,546,000. Certain of the facility lease agreements provide for escalation in lease payments based on inflation and give the Fund the option to renew the agreements beyond their original terms.

Claims

During the ordinary course of business, certain product liability claims have been brought against the Fund and its suppliers. Management has contested the validity of these claims, believes that they are without merit and that any possible settlement will have no further material impact on the financial position or results of operations of the Fund.

12. Employee benefit plans

The Fund sponsors a Registered Pension Plan (a defined contribution plan) for Canadian salaried and certain hourly employees (the "Canadian Plan") and a 401(k) Retirement Savings Plan for regular salaried and regular hourly United States employees (the "U.S. Plan"). The total pension expense related to the U.S. Plan and the Canadian Plan was \$571,000 for the period ended December 31, 2002.

The Fund also sponsors an unfunded Salaried Employee Retirement Pension ("SERP") plan for a small number of former management employees. In 1997, the Fund altered its SERP arrangement and froze membership and benefits payable in this plan as of that date. The remaining plan participants are no longer active employees of the Fund. The Fund has accrued the full actuarially determined liability in the financial statements.

13. Segment information

The Fund has one reportable business segment, related to the harvest, manufacturing and sales of horticultural growing media. Substantially all assets of the business support these operations. Geographic segment information is presented as follows:

	Period from March 27, 2002 to December 31, 2002	
Net revenue		
United States		
Net revenue – external customers	\$	101,062
Canada		
Net revenue – external customers		17,134
Net revenue – intercompany		95,038
Mexico and other		
Net revenue – external customers		11,471
Eliminations		(95,038)
	\$	129,667

	December 31, 2002
Property, plant and equipment	
United States	15,025
Canada	112,684
	\$ 127,709
Goodwill	
Canada	22,973
	\$ 22,973
Other intangible assets	
United States	24,298
Canada	5,191
Mexico and other	2,831
	\$ 32,320

14. Financial instruments

Forward currency contracts:

As at December 31, 2002, the Fund had forward exchange contracts, related to monthly projected distributions to unitholders in 2003, to sell US\$16,426,000 with a weighted average exchange rate of \$1.575. The unrealized gain on these contracts at December 31, 2002 amounted to \$108,000.

Other financial instruments:

As at December 31, 2002, the carrying amounts of accounts receivable, bank indebtedness, operating line, accounts payable and accrued liabilities, and distribution payable to unitholders approximate their fair values.

Concentration of credit risk:

The Fund is subject to credit risk primarily through its accounts receivable balances. Credit risk on accounts receivable balances are minimized as a result of the large customer base. The Fund does not require collateral for its accounts receivable. Certain customers are granted deferred payment terms.

Sun Gro Horticulture Income Fund

Douglas D. Allen

Director

A retired executive, Doug Allen has served as Chairman Emeritus of Hines Horticulture since June 2000. Previously, he was Chairman of the Board of Hines between 1995 and 2000, and President of Hines Nurseries, Inc. from 1984 to 1995.

W. John Dawson

Trustee and Director

John Dawson recently retired as a partner of a major international accounting firm after 37 years of practice. He was President of the B.C. Institute of Chartered Accountants from 1998 to 1999, and has served on various community and charitable boards.

John T. Goldsmith

Trustee and Director

In addition to his roles as First Vice Chairman of Westminster Savings Credit Union, John Goldsmith is the president, director and controlling shareholder of a consulting company and two retail companies. He previously spent 23 years with a major Canadian chartered bank, where he held various senior management positions.

Roderick T. Senft

Director

As a Managing Director of Tricor Pacific Capital Inc., Rod Senft participates on the board of a number of Tricor portfolio companies and income funds, including Tree Island Wire Income Fund, Swiss Water Decaffeinated Coffee Income Fund and Ag Growth Industries. He was previously a partner with a major Vancouver law firm.

T. Richard Turner

Trustee

Rick Turner is President and Chief Executive Officer of International Aviation Terminals Inc. and President of IAT Air Cargo Income Fund. Before joining IAT in 1988, he held management positions in the financial services industry. He currently chairs the B.C. Lottery Corporation and serves as a governor of the Vancouver Board of Trade.

Mitchell J. Weaver

Trustee and Director

Prior to joining Sun Gro as President and Chief Executive Officer in 1997, Mitch Weaver worked for Weyerhaeuser Company, an international forest products company, for 16 years. His last management assignment with Weyerhaeuser was as General Manager of a \$100 million-plus packaging operation in Salinas, California.

Corporate Information

Sun Gro Horticulture Canada Ltd. and Subsidiaries

Officers

Clarence Breau
Vice President, Eastern Region

Mark Spong
Vice President, Western Region

Robert Sytsma
Vice President, Central Region

Daniel A. Turner
*Vice President, Business
Development*

Mitchell J. Weaver
*President and
Chief Executive Officer*

Bradley A. Wiens
*Vice President, Finance and
Chief Financial Officer*



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Investor Relations

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Auditors

PricewaterhouseCoopers LLP
Vancouver, British Columbia

Trust Units listed

The Toronto Stock Exchange
Trading Symbol: GRO.UN

Transfer Agent

Computershare
Trust Company of Canada

Annual General Meeting

The Annual General Meeting of
Sun Gro Horticulture Income Fund
will be held at 1:30 p.m. on
Wednesday, June 4, 2003
at the Fairmont Hotel Vancouver
900 West Georgia Street
Vancouver, B.C.

